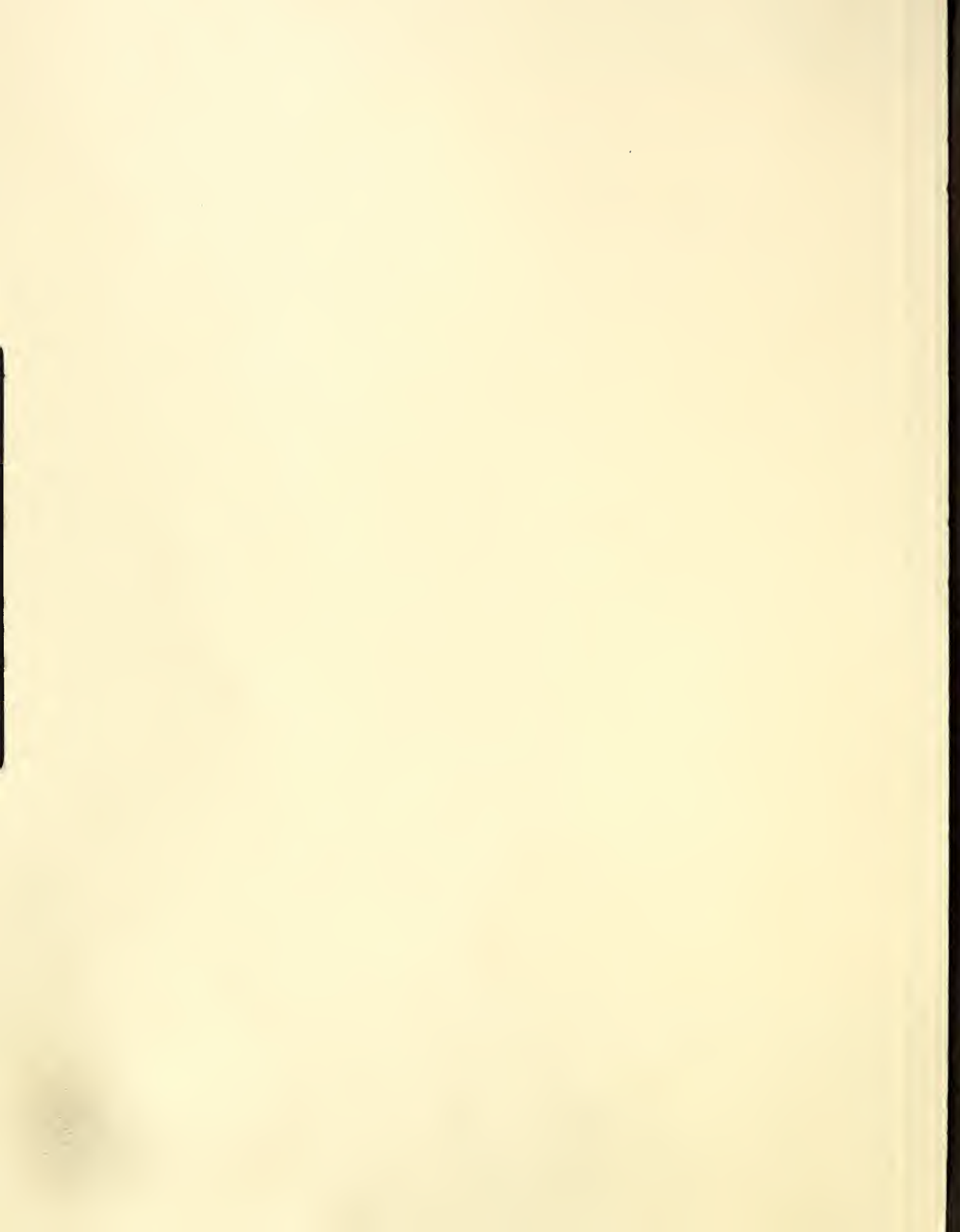


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UNITED STATES DEPARTMENT OF AGRICULTURE
Agricultural Research Service
Farm Economics Research Division

3 ARE FARMERS LOSING THEIR RIGHT TO MANAGE
THEIR FARMS BECAUSE OF CONTRACT FARMING?

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A good many farmers have been delegating or exchanging farm management rights for many years. I say "exchanging" rather than "losing" because they have traded management rights for something else. Contract farming or vertical integration has been only one of the forces responsible. The primary cause has been technological change, bringing with it increased commercialization and specialization of agriculture, expansion in the size and capitalization of farms, and a tendency toward production of chronic surpluses. One might say that contract farming and the decline in the management rights of farmers have developed out of the same causes. Contract farming usually does, indeed, reduce the management rights of farmers since the delegation of management is an important feature of such contracts. In fact, contract farming is usually defined as consisting of an agreement to share farm decision-making responsibilities with another party or firm. At the same time, delegation of rights by contract or otherwise may not reduce the total managerial responsibilities of the farmer. In fact, his responsibilities may increase if contracting helps him expand his business.

Most of the experts are agreed that contract farming is reducing the management rights of farmers. Some of them think it is inevitable and beneficial. For example, Earl Crouse, a vice president of Doane Agricultural Service says: "...it is increasingly necessary for the farmer to become a cog in a well-oiled, vertically integrated marketing machine." 2/ Dean Butz of Purdue University says vertical integration may move the farmer "...in the direction of a quasi-riskless, semi-guaranteed wage earner. But this is not necessarily bad, per se. He may be, and frequently is, better off this way than he was before." 3/

The important question is not whether contract farming reduces the number of management rights of farmers, but whether it shifts large numbers of them to a wage- or share-crop status. The effect on incomes is of less importance.

1/ Delivered at the Second Farm Management Short Course, Farm and Home Week, Clemson Agricultural College, August 12, 1958.

2/ Crouse, Earl F. Why is Integration Developing in Agriculture?, Natl. Inst. of Animal Agr., Purdue Univ., April 1958.

3/ Butz, Earl. The Social and Political Implications of Integration, Natl. Inst. of Animal Agr., Purdue Univ., April 1958.

Ownership of property legally entitles a person to broad rights to its use, unrestricted so long as use is not injurious to someone else. Traditionally, these rights applied to farmers have been:

1. To produce what one pleases.
2. To produce whatever quantity one wishes.
3. To produce when one chooses.
4. To decide upon the methods of production.
5. To conserve or exploit resources as desired.
6. To sell when and where one wishes.
7. To dispose of the property as one sees fit.

These are the rights of an owner-operator. A lessee is a kind of contract farmer, and his rights are defined in the rental agreement. If he is a sharecropper, he probably makes only a few independent management decisions. Many owner-operators have bargained away parts of some of these rights in exchange for capital. Others are prevented from effectively exercising some of them because of insufficient funds. For example, the right to build up and improve property cannot be effectively applied by a farmer who is in urgent need of cash.

Farmers do not produce in isolation, but operate in an economy that is becoming more and more interdependent and commercialized. They deal with other people who also have rights. They sell to consumers who have the right to choose among foods and fabrics, and to seek the most value for their money. They have a right to decide how much fat they want on a pork chop, for example. Farmers also deal with business firms that have rights to manage their property in the most profitable manner as long as they abide by general rules of equity and fairness. Finally, farmers have dealings with the Government, and since 1933 with the first Agricultural Adjustment Act, the farmer's right to produce has been strongly affected.

The extent of contract farming has been increasing in recent years, and available evidence points toward continued growth. There are two chief reasons for this; one of these is the development of mass merchandising, and another is the increasing advantage of larger-scale production and processing.

Mass merchandising requires a continuous flow of farm products and the standardization of quality of these products. Chain stores have found that contracts with processors and sometimes with growers help to make the flow of farm products more systematic and help to control quality.

Opportunities for greater efficiency through increased volume can be found all along the line from supermarkets back to processors, to farmers, and to the firms that supply farmers with mixed feed or fertilizer. Increased volume helps to reduce unit costs in many instances. Contracting is a long established way of expanding volume. For example, supermarkets contract with broiler processors in order to assure themselves of a large and steady flow of dressed birds. Processors contract with farmers in order to permit continuous operation of assembly-line killing and dressing equipment. Feed dealers contract with farmers in order to build up a high volume of feed sales.

Farmers contract with feed dealers, processors, or chain stores for the same reasons--they want to increase income by expanding output per man or per dollar of investment. But they are also influenced by other factors. They may contract in order to shift risk. In several studies risk protection is shown to be very important in broiler contracts. In some instances, farmers can obtain needed capital only by entering into a contract, and sometimes they contract in order to gain an assured market outlet.

Some rough estimates of the present extent of contract farming and other forms of agriculture-business integration are contained in a USDA publication just issued. ^{4/} To cite a few examples, about 90 percent of the vegetables grown for canning or freezing are produced under contract. About half the fresh-market vegetables and melons are supplied by integrated operations. Cotton ginneries and cottonseed oil processors frequently enter into contract-farming arrangements with farmers. They extend credit as a means of increasing the volume of business for their gins or mills. In tobacco, contract farming is common only in shade-grown areas and in production of the few hundred acres of aromatic or oriental tobacco. Vegetable seeds are usually grown under contract, as is hybrid seed corn.

Farmer cooperatives are important in the marketing of dairy products. Usually they operate through agreements that are not contracts in a formal sense. About 95 percent of broiler production is integrated. Most of this is under contracts between farmers and feed dealers or processors, but there is a good deal of production by dealers and processors who hire wage-labor. Hatching eggs are usually produced under contract. Probably less than 5 percent of table eggs are contracted, but interest is growing and experimental plans are being tried. There is growing interest, especially in the West, in custom or contract feeding of beef cattle and sheep. Probably less than 2 percent of hog production is contracted, but feed companies and packers are experimenting with contracts, particularly around the fringes of the Corn Belt and in the South.

The wide extent of contract farming, and the tendency for it to expand is readily apparent. What are the probable effects on important property and management rights as traditionally exercised by farmers?

First, let us consider the right to produce what one pleases. One is at once reminded that for crops like cotton and tobacco, the right to produce depends upon having an allotment. For these and other "basic" crops, farmers have accepted some restrictions on the right to grow the crop. Allotment programs may be thought of as a special form of contract farming.

The willingness of a majority of producers to sanction allotment programs is an indication of the growing willingness of farmers to modify individual rights in the interest of price stabilization. Professor Benedict, ^{5/} states that the passage of the original AAA Act in 1933 marked the beginning of a profound change in farmers' attitudes toward the centralized planning of what to produce.

^{4/} U. S. Dept. of Agr. Agr. Inf. Bul. 198, Contract Farming and Vertical Integration in Agriculture, July 1958.

^{5/} Benedict, Murray. Farm Policies of the United States, 1790-1950. New York: 1953, p. 348.

For some commodities it is necessary to have a contract in order to have a market for the product. This is true of a few of the speciality products such as sugar beets, vegetable seeds, and hatching eggs where control over the conditions of production is vital to the processor or assembler. It is also said to be true of broiler production in some areas where processing facilities are limited. In such areas, broiler processors must always be ready to handle birds grown under contract, and they tend to take birds not grown under contract only as facilities are available. A broiler study in Maine found that 17 percent of independent growers occasionally had difficulties in finding a market for their birds. 6/

Looking ahead, it seems probable that contract farming may at times limit the right to enter at will into the production of whatever commodity one may choose. For example, if the broiler market should become saturated and processors and feed dealers sought to reduce production, would they try to avoid contracting with producers who had difficulty in maintaining quality, or who were inefficient in feed conversion? The Maine study mentions among grower incentives "...the likelihood of being dropped if satisfactory performance is not attained." 7/ Some of the private and cooperative egg marketing firms insist on the right to refuse to contract with producers who will not meet their standards.

The right to decide upon the volume of production is closely related to the right to produce at all, and again, allotment programs should not be forgotten. It may be noted that most of the commodities closely integrated through contract-farming are not controlled through government allotment programs. This has been interpreted as an indication that agriculture-business integration is an alternative means of production adjustment. I doubt this to be the case. There is at least one closely-integrated crop, sugar beets, that is regulated by government allotments and quotas. Up to now, contract farming is not the predominate mode of production for any major commodity except broilers. It is important in milk production, but in this case is closely interconnected with State and Federal marketing orders and agreements. I do not look for contract farming to be a self-sufficient device for regulating output. But, it may become a basis for developing new farmer-processor-government joint programs of production adjustment.

The right to schedule production according to climatic conditions and competing demands on the farmer's time has long been an established right of management. This has been especially important for hogs, poultry, and the fattening of cattle and sheep. These are enterprises that can be fitted in to take up the slack in labor time and in other resources. But the exercise of this right is not always in line with the interests of processors and supermarkets, and the differences between rights of producers and the desires of business firms have widened.

Modern large-scale processors or supermarkets need an even and scheduled flow of products. In this way they can keep overhead down and efficiently utilize labor. In order to reduce supply uncertainties, these firms are interested in contracting with farmers. In exchange they offer

6/ Saunders, Richard F. Contract Broiler Growing in Maine. Maine Agr. Expt. Sta. Bul. 571, May 1958, p. 25.

7/ Ibid., p. 32.

a price premium or a reduction in price uncertainties. The extension of contract farming will tend further to restrict the farmer's freedom of choice in the timing of production.

An important area of farm management decision-making is concerned with the methods of production to be followed. A high proportion of contracting or integrating firms concern themselves with some aspects of production methods. This is true for broilers, eggs, hogs, sugar crops, vegetables, seeds, forest products, and most other commodities. Why is this feature so common in contract farming? One reason is that specification of varieties and equipment, and supervision in the field or farmyard is an effective way of controlling quality of product. This is especially important for such commodities as certified seeds, milk, or eggs. Careful supervision also is important for contract programs that involve credit or the furnishing of resources as is common with the feed-dealer package plans for broilers, turkeys, or hogs. Supervision is also useful where new producers are being encouraged to enter production. This is frequently the case with broiler and pig contracts. Perhaps another reason for the provision of fieldmen and supervision is that many of the contracting firms believe firmly in research, and feel that technical progress benefits both parties to the contract by making growers more efficient and productive.

The extent to which day-to-day management decisions are assumed by the contractor varies a great deal among the commodities. In broiler contracts, a high proportion of management practices are assumed by, or at least shared with, business firms. In most of the crop contracts, only a few production decisions are affected. For example, a canning firm may insist on certain bean varieties because of palatability or for uniform maturity so that it can use a bean harvester on the crop.

There will probably continue to be a wide range in the extent to which farmers assign their rights to determine the production practices to be followed. Farmers who keep abreast of technical developments and who do not need, or choose, to be financed by a contractor will probably continue to make most of their own decisions.

The farmers' final production decision is the choice of a market. Contract farming alters the time at which the farmer makes this decision. Usually the farmer's choice of a buyer is made at the time he enters into a contract. As a rule this is before planting time, or before a batch of broilers is started, so the flexibility of the farmers' marketing decision is considerably reduced. Also the manner in which price is arrived at may be altered. Traditionally, farmers have sold their products on markets at which there was competitive bidding among buyers, and a price was established that presumably reflected demand and supply conditions. Many contract deals are made on the basis of auction market quotations, so that the usefulness of an open competitive market as a barometer of supply and demand may continue as long as a significant part of the commodity is handled on the open market. But how will a farmer decide what the price "ought to be" if all, or nearly all, of a commodity is exchanged through separate contract bargains? If there are enough contract buyers, bidding among them may make the market as competitive as before, but there is a tendency for contracting arrangements to become formalized and unresponsive to changing economic conditions. Share-tenure arrangements are an illustration.

If the expansion of contract farming is inevitable, as many believe it to be, farmers are faced with three important questions. Is contract farming likely to put some of them out of business completely, at least as producers of highly-integrated commodities? How can farmers preserve as many of their management rights as possible? and, How can farmers make sure they are adequately compensated for any rights given up?

With respect to the first question, I believe integration will reduce the total number of farms because it tends to encourage expansion in size and efficiency of the individual producing unit. I do not foresee an agriculture dominated by large corporation farms. I think farming will remain primarily a family-scale business. But if most farms were highly efficient, mechanized, family units the total number needed for our present level of output would be substantially below the three and one-third million commercial farms reported in 1954 by the Census. In 1954 about 28,000 farms produced more than 90 percent of the broilers raised in the United States. It has been pointed out that our hog requirements could be met by 60,000 farms having 100 sows each. We now have 2 1/2 million farmers who raise hogs. It has also been pointed out that a little over 200,000 farms with 100 cows each could supply our present milk requirements. There are now about a half million dairy farms and almost 3 million farms on which one or more milk cows are kept. At the present time there are some efficient family farms that have as many as 100 sows or 100 milk cows. There will be more such farms in the future, and while it is not likely that hog and dairy production will become as concentrated as have broilers, substantial adjustments in the number of commercial farms are in prospect. This will lead to a decline in the total number of farms or a shift of some small commercial farms into part-time farming, or both. Most farmers who move out of commercial agriculture will do so because they do not have sufficient resources to meet the demands of an increasingly more technical agriculture. I believe that only occasionally will farmers be "frozen out" by inability to obtain a contract.

With respect to the retention of management rights, one may ask how many of these rights farmers should try to keep? If someone else, for example, a feed dealer, has more knowledge of broiler rations than a particular farmer, should that farmer stoutly insist on retaining the right of determining the ration? Or would he be better off to exchange it for a profit-sharing deal? An economist may give a different answer to this question than would a fervent agrarian. On the other hand, any well-informed farmer, who has kept up-to-date with technology should be very careful in delegating any of his managerial responsibilities. If he is also adequately financed, he may have little to gain from contract farming.

Farmer cooperative organizations are frequently advocated as one solution to the integration problem. As a broiler processor or a meat packer integrates backward toward the farm, so farmers can jointly integrate forward into processing and marketing. But in either case the individual farmer is contracting with a business firm and the details of the contract are similar. In the cooperative, however, the farmer should be able to retain a larger voice in over-all management policies.

Another way for farmers to retain decision-making rights is to seek alternatives to contract-farming. The needs of mass merchandisers for quality, and for a regular and dependable flow of products might also be met by improving market grades and standards, by establishing price margins that adequately reflect quality differentials, and by educating farmers to produce for the needs of their market. Market agreements and orders can also be used to improve the scheduling of production and quality of products.

The third question is closely related to the second. The devices that can be used to retain management rights can also be used to improve farmers' bargaining power if they decide to give up certain management functions. Farmer cooperatives, for example, are a means by which farmers may receive more of the financial benefits of integration. In a cooperative system, the pricing of farm products or of farm supplies is not quite so crucial, since at least a part of what the farmer might lose from too low a product price or too high a feed price would be returned to him as a patronage refund. Also, the cooperative may perform a yardstick function in developing contracts that are more favorable to the producer. A broiler study made in 1955 in lower Delaware by the Farm Economics Research Division, Agricultural Research Service and the University of Delaware indicated that a large farmer cooperative was helping farmers get better deals in that area at that time.

Cooperative organizations also can be established to assist farmers in bargaining with business firms. Frequently, these organizations work within a framework of a State or Federal marketing order or agreement. Such organizations exist in many dairy areas. Growers' associations have long been active in contract negotiations with sugar beet and vegetable-processing firms. Broiler growers in some areas are attempting to organize bargaining associations.

Farmers should be concerned about keeping the essential rights to the management of their farms in their own hands either as individuals or through cooperatives, or both. Farmers make up only about a third to a fourth of all the people who work to produce, process, and market farm products, including those who produce farm supplies. If large numbers of farmers should cease to assert major responsibilities for farm management and the risks of production, they might become submerged in the larger total of what has been called the "agribusiness sector." If the people who live out on the farms cease to make the vital decisions, they will become in effect piece workers, sharecroppers, or wage hands, and other entrepreneurs that have assumed the risks and responsibilities of management will eventually become the leaders of, and the spokesmen for, agriculture.

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